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In The

Supreme Court of the United States

OCTOBER TERM, 1985

RALPH MICHAELS, EVERETT B. MICHAELS AND EVRA CORPORATION (HYMAN-MICHAELS COMPANY),

Petitioners,

vs.

JOSEPH MICHAELS,

Respondent.

PETITIONERS' REPLY BRIEF IN SUPPORT OF THEIR PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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Introduction

Petitioners submit this Reply Brief to address arguments first raised by Respondent ("Joseph") in his Brief in Opposition to Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit (hereinafter "Opp.").[1] As set forth below, Joseph sidesteps the vital legal question of disclosure under the securities laws which arises from the Seventh Circuit's opinion. However, neither sidestepping nor Joseph's efforts to portray this as a "factual" dispute diminishes the wide ranging conflict among the circuits regarding the materiality of premerger activities or obscures the ripeness of this important issue for review at this time.

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[1] Petitioners use the same defined terms as in their Petition.

I. THIS PETITION PRESENTS ONLY A SINGLE LEGAL ISSUE; THE TRULY MATERIAL FACTS HAVE NEVER BEEN IN DISPUTE

Although Joseph struggles to depict this case as primarily factual, there really are no *material* facts in dispute. All parties agree that on January 27, 1976, the date Joseph sold his Hyman-Michaels stock, an acquisition of Hyman-Michaels by Azcon was neither reasonably certain nor even on the far horizon. As of January 27, the two companies had not reached any tentative agreement, they had not had any discussions, and, in fact, were not even aware of each other's existence as potential merger partners. The sum total of what occurred by January 27 was that in an attempt to boost his credibility as a potential broker, Ralph's friend Littlejohn had mentioned several "theoretical possibilities" which he thought *might* be interested in Hyman-Michaels, not one of whom had yet been contacted. Even if one accepts as true all of the supposedly crucial facts which Joseph claims that Petitioners omitted from their Petition (Opp. at 10-11),[2] one does not advance one inch closer to an acquisition

[2] This is not to say Joseph's reliance on the Seventh Circuit's factual narrative (with editorial footnotes) should pass completely without comment. Such factual narrative was not intended as findings of fact of the type generated by district courts under Rule 52(a), Fed.R.Civ.P. The danger of adopting verbatim an appellate court's factual narrative is illustrated by the many erroneous or partially correct statements found therein. For example, although Everett did, in fact, say "I don't give a damn," when lawyer Chapman told him of Joseph's desire to retain his lucrative sinecure with the Company, the Seventh Circuit does not disclose Everett's *reason* for this emotional response. Everett was upset with Joseph for trying to thwart his efforts to put his estate in order by threatening to withhold consent to the sale of Everett's stock to Hyman-Michaels. Everett was doubly perturbed because, when Everett had asked Joseph earlier whether he should attend the meeting where Joseph's threat to withhold consent was first announced, Joseph falsely told Everett "no", nothing would happen that would affect the sale of Everett's stock.

by Azcon of Hyman-Michaels' metals business assets as of January 27, 1976.

II. THE CONFLICT AMONG THE CIRCUITS REGARDING MATERIALITY OF PREMERGER ACTIVITIES IS CLEAR

Joseph seeks to minimize the split of authority among the circuits by arguing (1) that the Second, Third, Sixth, Eighth and Ninth Circuits do not draw a "line" before which premerger activities are not material and (2) that even if those circuits do draw a line, they are factually distinguishable from the case at bar. Joseph is wrong on both counts. Cursory review of cases from the Second, Third, Sixth, Eighth and Ninth Circuits[3] reveals that each has drawn a line and thus created a reasonably clear legal rule separating *immaterial* musings, intentions and speculation from *material* facts relating to reasonable probability of a merger or the existence of an agreement in principle. The holdings of those cases are neither ambiguous nor obscure. Unlike the Seventh Circuit, which has obliterated the line, each of the other circuits does draw a line, although in slightly different places. These lines are legal rules, and they were not "created" by Petitioners (Opp. at 16). They were developed by the other circuits and for good reason. Premature disclosure of inchoate premerger activities inherently tends to mislead.

The "public company" grounds on which Joseph attempts to distinguish *Greenfield*, *Reiss* and *Starkman* are untenable. This Court has never suggested different materiality tests for "public" and "private" companies. It is ironic that Joseph,

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[3] *Starkman* v. *Marathon Oil Co.*, 772 F.2d 231 (6th Cir. 1985); *Greenfield* v. *Heublein, Inc.*, 742 F.2d 751 (3d Cir. 1984), *cert. denied.*, 105 S.Ct. 1189 (1985); *Reiss* v. *Pan American World Airways, Inc.*, 711 F.2d 11 (2d Cir. 1983); *South Coast Services Corp.* v. *Santa Ana Valley Irrig. Co.*, 669 F.2d 1265 (9th Cir. 1982); and *Missouri Portland Cement Company* v. *H.K. Porter Company, Inc.*, 535 F.2d 388 (8th Cir. 1976).

champion of the case by case "no rule" approach to materiality of premerger activities, here argues for "public-private" line drawing on a scale far more venturesome than the lines drawn by the other circuits as to materiality of premerger discussions. Although the SEC could tailor disclosure rules to the size of the company under disclosure obligations (Opp. at 18), the SEC has not done so, and its refusal highlights the flaw in Joseph's position, which would require courts to eke out on a case by case basis clear standards of conduct best suited to rulemaking procedures available to the SEC or other administrative agencies. Joseph's suggestion is especially inappropriate because the SEC is on record as *eschewing* any "public-private" distinction, concluding instead that *all corporations* should be subject to the same murky non-criteria set forth in *In re Carnation Co.*, Sec.Act.Rel. No. 22214 (July 8, 1985), *reprinted in* (1984-1985 Transfer Binder) Fed.Sec.L.Rep. (CCH) ¶ 83,801, and by the Seventh Circuit below.

Examination of Joseph's supposed "no rule" cases only highlights the conflict between those cases and the "rule oriented" approach of *Starkman*, *Reiss* and *Greenfield*. It is also significant that not one of Joseph's cases is less than seven years old, and all but *Holmes* v. *Bateson*, 583 F.2d 542 (1st Cir. 1978), predate *TSC Industries, Inc.* v. *Norway, Inc.*, 426 U.S. 438 (1976). Moreover, the case by case approach is actually more an *ex post* description of what these cases did than a prescription for success in formulating rules regarding disclosure of premerger activities. Extensive litigation under Rule 10b-5, 17 C.F.R. § 240.10b-5, is of fairly recent origin. The fact that a few early decisions advocated a case by case approach in the absence of significant scholarly or precedential authority should not impede development of modern rules responsive to the needs of society and the current corporate environment. Resolution of the present conflict among the circuits is necessary to discourage the kind of forum shopping among circuits which is bound to occur now that the Seventh Circuit has staked its claim in a legal no-man's land as to premerger disclosures.

III. THE SEVENTH CIRCUIT'S DECISION UNDERMINES THE TREND IN THIS COURT TOWARD PREDICTABLE AND REASONABLY CLEAR GUIDELINES FOR SECURITIES TRANSACTIONS

Efficient functioning of our economy depends on rational and knowable rules governing corporate behavior. Concrete recognition of this dependence is the lasting legacy of decisions such as *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975), *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976) and, more recently, *Landreth Timber Company* v. *Ivan K. Landreth*, 471 U.S. ____, 105 S.Ct. 2279 (1985) and *Gould* v. *Ruefenacht*, 471 U.S. ____, 105 S.Ct. 2308 (1985). Joseph would have this Court disregard the teachings of these cases and ignore the lessons learned about premerger disclosure in decisions such as *Greenfield*, *Reiss* and *Starkman*, in favor of an inherently unpredictable case by case approach. However, contrary to Joseph's argument, reasonably clear guidelines as to when premerger activities become material *are* essential in order for business persons to know *ex ante* when disclosure must be made and so that trial courts will have rational rules on which to base jury instructions. Case by case analysis will still be appropriate for those situations which pass the threshold test of materiality. Foreclosing nondisclosure suits based on legally immaterial premerger activities is no more incompatible with case by case treatment than is the "purchaser-seller" rule of *Blue Chip Stamps* which establishes a rule foreclosing such suits by persons who did not purchase or sell a security.

CONCLUSION

We return to where we began. Since *TSC*, the circuits have attempted to chart a course toward principled and workable guidelines for disclosure of premerger activity. With merger activity at an all time high, the business and investment community must have such guidelines, but to date the circuits have not provided them. The Seventh Circuit's decision

throws the picture into further disarray and makes the issue ripe—if not overripe—for review.

Respectfully submitted,

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